

DTRE DOES...

THE ECONOMY ECONOMIC PREVIEW MARCH 2022



WRITTEN BY

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KEY POINTS

1. Ukraine crisis will hit the global recovery from coronavirus
2. Markets are pricing in five rate hikes this year – 1.75% by November
3. GDP in Q4 will only be about 1.5% higher than a year earlier

If it's not one thing it's another. With Covid seemingly in the rear-view mirror, Russia's invasion of Ukraine and an increasing cost of living crisis, caused by a mix of soaring inflation and fiscal own goals, has darkened the mood around the UK's economy.

There is no doubt about it, the prospect of Europe's biggest conflict since the end of World War Two has muddied the outlook for the UK economy, as well as the global recovery overall.

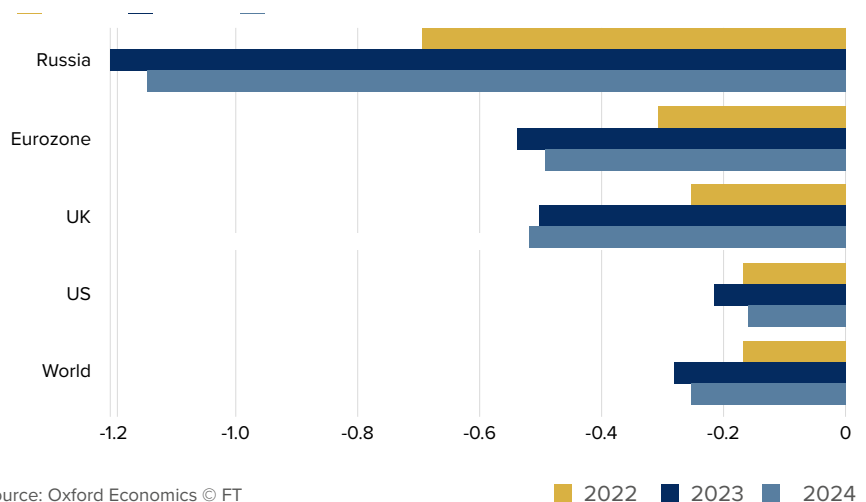
Russia's invasion of Ukraine on Thursday 24th February shook financial markets and currently whilst the impacts are being felt much more by Russians and obviously the people of Ukraine, a global geopolitical crisis like this will

have plenty of in-direct consequences, including the possibility of a second global recession in three years, should the war escalate seriously and energy prices soar as a result.

In addition, prior to the invasion of Ukraine, the cost-of-living crisis was grabbing all the headlines in the UK and whilst it may have disappeared from the front pages, it hasn't unfortunately gone away at all.

Fig 1. Estimated Impact of Ukraine crisis on global economic growth

% change in gross domestic product from no conflict baseline



Source: Oxford Economics © FT

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Many forecasters and institutions have hiked their inflation forecasts since our last Economic Preview in late January and now expect inflation to hit 8.0% in April, in response to the increase in oil prices over the last week, with inflation continuing at c.6.7% on average through Q4 2022 as Ofgem increases its energy cap by about 30% in October – in response to the huge surge in gas futures prices as a result of the Russian invasion and well ahead of the previously assumed 11%.

Further to the slowing global growth and rocketing inflation the UK's own fiscal policies are set to reduce real household disposable income by 2%, that's the most since records began in

1948. The fiscal policies responsible for the decline will be next month's national insurance increase, together with the freeze on income tax thresholds and the fact that benefit payments will increase by just 3%, well below inflation.

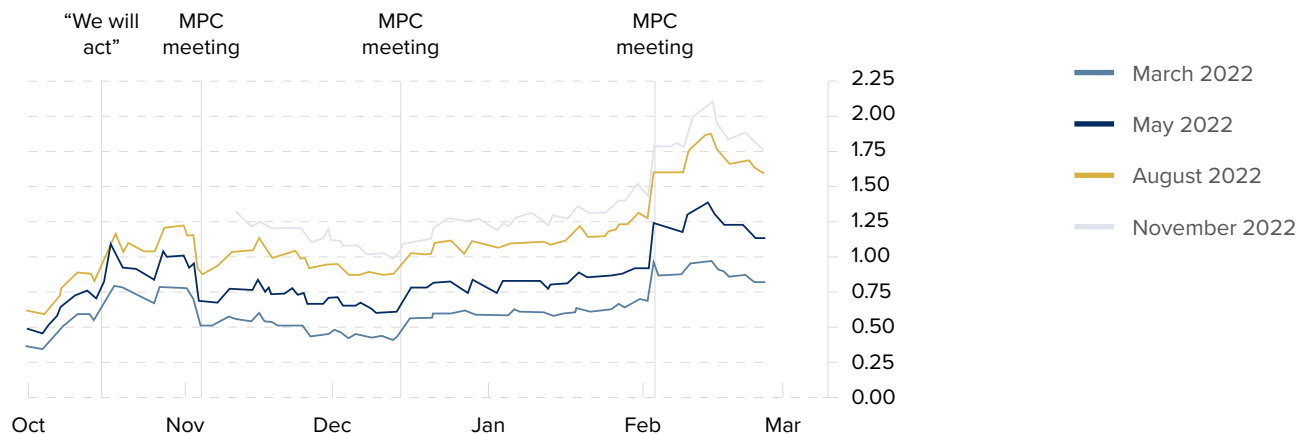
Whilst some commentators expect a U-turn over at least one of the tax or N.I. changes, Sunak's ability to help out households has been eroded by the forthcoming surge in the government's debt interest payments (due to surging inflation), and the likely increase in military spending.

Despite the reasons laid out and a GfK consumer confidence survey last Friday (25th February) that showed households are currently as pessimistic about the outlook for their personal finances as they were at the peak of the Covid-19 crisis, the markets are still pricing in five more 25 basis point rate hikes this year.

However, at DTRE we don't see that being realistic as it is unlikely domestic demand will be strong enough for inflation to become so embedded as to require that many rate hikes.

Fig 2. Markets Expect the MPC to Raise Interest Rates to 1.75% by November's Meeting

Five more 25bp rate hikes this year? That's unlikely
Level of Bank Rate at upcoming MPC meetings implied by OIS rates, bp



One area of positivity remains business investment and with Covid and Brexit in the rear-view window we should see a rebound in 2022. Firms' balance sheets, on aggregate, are in good shape, profit margins are healthy, and surveys of investment intentions have risen to increasingly high levels and Rishi Sunak's "super deduction" policy also will spur firms to invest before April 2023.

Weakness however remains in exports, which continue to struggle and unfortunately, whichever way you like to cut it, is without doubt, due in large part to Brexit.

The export orders balance of Markit's manufacturing survey fell decisively below 50 in February and undershot the equivalent Eurozone index for the 14th consecutive month.

Consequently, overall growth in 2022 looks set to be a bumpy ride, with a 0.6% increase in Q1'22 followed by a fall in Q2, under the weight of energy price and tax rises.

Then expect a rebound of sorts in Q3 and a stagnation of that rebound in Q4 when energy prices jump again,

leaving GDP in Q4 2022 only 1.5% higher than a year earlier.

Finally, the property sectors historic performance as an inflationary hedge and its safe-haven status should help shelter it from the worst of any crisis.

We believe investors will appreciate the inflation protection within the leases and this in-turn will help keep volumes elevated, particularly for industrial and logistics assets with a strong tenant line-up.